LESSON · TAX & WITHDRAWALS

Which Account to Draw From First in Retirement

The order you draw from taxable, Traditional, and Roth accounts can matter as much as how much you withdraw — get it wrong and RMDs, IRMAA, and taxable Social Security all get bigger than they needed to be.

Read time: 9 minutes **Level:** Intermediate **Includes:** Knowledge check

Most retirees have savings spread across a few different types of accounts — a taxable brokerage account, a Traditional IRA or 401(k), and increasingly a Roth account too. Each one is taxed differently, which means the *order* you draw from them can matter as much as how much you draw in total. Get the sequence right and you can meaningfully reduce lifetime taxes; get it wrong and you can push yourself into higher brackets, bigger IRMAA surcharges, or more taxable Social Security than necessary, all without spending a dollar more.

The three account types, taxed three different ways

TAXABLE

Brokerage / savings accounts

Already-taxed money. Withdrawals aren't taxed again, though ongoing dividends, interest, and realized capital gains are taxed each year as they occur. Long-term capital gains often get preferential rates, sometimes 0% for those in lower brackets.

TAX-DEFERRED

Traditional IRA / 401(k)

Every dollar withdrawn is taxed as ordinary income in the year it's taken, and eventually RMDs force withdrawals whether needed or not (see the RMD lesson).

TAX-FREE

Roth IRA / Roth 401(k)

Qualified withdrawals are entirely tax-free and carry no RMDs during the original owner's lifetime, making this the most flexible bucket — and often the one worth preserving longest.

The traditional default, and why it's often wrong

The conventional rule of thumb is: spend taxable accounts first, then tax-deferred, and save Roth for last. The logic is sound as far as it goes — let tax-deferred and Roth balances keep growing tax-advantaged as long as possible. But followed rigidly, it has a real cost: draining taxable and tax-deferred accounts first, then hitting RMD age with an enormous, undiminished Traditional balance, can force much larger RMDs later than if some of that balance had been drawn down (or converted) earlier in retirement, in lower-income years.

Worked example

Two retirees each have $1,500,000 split evenly across taxable, Traditional, and Roth accounts. Retiree A follows the rigid "taxable first, then Traditional, Roth last" rule. Retiree B instead draws a blend each year — some taxable, some Traditional (deliberately filling up the lower tax brackets each year, similar to the strategy in the Roth Conversions lesson), and lets Roth continue growing. By the time RMDs begin, Retiree A's Traditional balance has kept compounding largely untouched and produces much larger forced RMDs, often pushing them into higher brackets and larger IRMAA surcharges than Retiree B, who smoothed the tax hit across more years by design.

"Fill the bracket" thinking, not "which bucket is next"

A more precise approach treats each year independently: look at how much room is left in the current, lower tax bracket, and draw enough from Traditional accounts (or convert enough to Roth) to use that room up — without spilling into the next bracket — then cover any remaining spending need from taxable or Roth accounts. This "bracket-filling" approach often beats a fixed bucket order because it responds to what's actually happening in a given year, including years with unusually low income (a gap year before Social Security starts, for example) where there's room to recognize more Traditional income cheaply.

Where capital gains and Social Security interact

Ordinary income "stacks" underneath capital gains and can push them into taxable territory

Long-term capital gains are taxed based on *total* taxable income, including Traditional withdrawals stacked underneath them. Drawing more from a Traditional IRA in a given year can push otherwise 0%-taxed capital gains into the 15% bracket, and can also increase how much of Social Security becomes taxable (see the RMD lesson for how that calculation works). None of these pieces can really be optimized in isolation from each other.

A practical mid-ground

Most retirees don't need to model this down to the dollar every year, but a workable middle ground is: don't treat "taxable first" as an absolute rule, review taxable income against current bracket thresholds each year (especially in the years before Social Security and RMDs begin), and consider modest Traditional withdrawals or Roth conversions in low-income years even before it's strictly necessary to fund spending.

Building a withdrawal sequence

- [ ] Don't assume a fixed "taxable, then Traditional, then Roth" order is automatically optimal — it can front-load RMDs into a much bigger future tax bill.
- [ ] Each year, check how much room is left in the current tax bracket before deciding which account to draw from.
- [ ] Use unusually low-income years (before Social Security or RMDs start) to draw more from Traditional accounts or convert to Roth at a cheaper rate.
- [ ] Remember that Traditional withdrawals can push capital gains and Social Security into higher taxable territory — don't plan each income source in isolation.
- [ ] Preserve Roth balances for later in retirement or for heirs, since they carry no RMDs and no tax on qualified withdrawals.

KNOWLEDGE CHECK

Test what you just learned

Answer four quick questions to test what you just learned.

1. What is the conventional default withdrawal order many retirees follow?

A. Roth first, then Traditional, then taxable

B. Taxable accounts first, then tax-deferred (Traditional), then Roth last

C. Whichever account has the highest balance

2. What's a downside of rigidly following that default order?

A. It has no downsides and is always optimal

B. It can let Traditional balances keep growing untouched, leading to much larger forced RMDs later

C. It causes immediate tax penalties

3. What does 'bracket-filling' mean in this context?

A. Filling out IRS tax bracket forms correctly

B. Drawing or converting just enough from Traditional accounts each year to use up room in the current, lower tax bracket without spilling into the next one

C. Always withdrawing the same fixed percentage from each account

4. How can a Traditional IRA withdrawal affect capital gains taxes?

A. It has no effect on capital gains

B. Ordinary income from a Traditional withdrawal stacks underneath capital gains and can push otherwise 0%-taxed gains into a higher bracket

C. It automatically reduces the capital gains tax rate

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